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The Manufacturers Hanover
Financial Digest
Economic Commentary, Selected Financial Data, and Business Indicators

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Despite The Dollar's Drop . . .

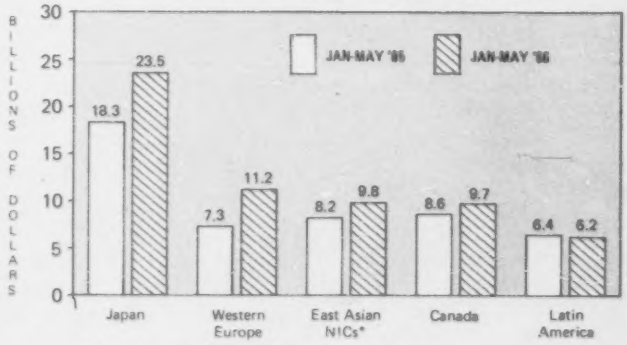
The sharp declines in interest rates, oil prices, and the dollar that occurred in 1985 and so far this year were widely expected to produce strong growth in the United States. However, with the second half of the year now underway, and the economy still moving sideways at best, growth forecasts are being scaled back. Even the Administration, among the most optimistic, predicting four percent annual growth in inflation-adjusted GNP this year, is expected to join in, lowering its growth forecast within the not-too-distant future. Thus, the question arises what went wrong and what can be done about it.

Perhaps the principal reason for today's lackluster growth pace is that a good chunk of consumer and business spending continues to be deflected abroad. The sharp decline in the dollar since February 1985 has failed to produce any noticeable improvement in U.S. trade performance. In fact, should current trends continue, this year's trade deficit will exceed 1985's record $148 billion figure. What is more, since total trade turnover (exports plus imports) currently represents some 15 percent of GNP versus only eight percent in 1970, the widening external deficit has become a substantial drain on U.S. economic performance.

To be sure, with the dollar slumping in the foreign exchange markets, this was not supposed to happen. But nearly a year and a half after the dollar began its almost nonstop decline against the other major industrial country currencies, the trade figures look as bad as ever, a reflection of the continued weakness in farm and manufactured exports, and the ongoing surge in imports. The U.S. trade deficit rose by over 25 percent in the first five months of this year from the same 1985 period, despite a better than 30 percent decline in the dollar against the currencies of Europe and Japan. Exports performed dismally, falling by almost four percent year-over-year, while imports rose by more than seven percent. In particular, foreign sales to Canada, Japan, Mexico and the United Kingdom all posted sizable declines.

Most recently, May's trade deficit of more than $14 billion did not come as a total surprise. The U.S. appetite for such foreign-produced products as autos, televisions and VCR's ensured that the manufactures deficit would remain large. What proved to be especially disappointing was the appearance of the first monthly farm-trade deficit since August 1971. Stepped-up purchases of produce from Mexico and higher-priced coffee from Brazil, along with diminished grain exports to the European Community and the Soviet Union, provided the one-two punch that put our farm trade in the red. The once-robust agricultural trade surplus, which peaked at nearly $27 billion in 1981, and once was the biggest single positive contributor to the U.S. trade balance, has virtually disappeared.

U.S. TRADE DEFICIT IN SELECTED AREAS: JANUARY-MAY 1986 VS. JANUARY-MAY 1985



*Includes Hong Kong, Singapore, South Korea and Taiwan

. . . The Trade Deficit Remains Huge . . .

One reason why the substantial currency realignments of the past year and a half have yet to prompt improved trade performance is that many European and Japanese companies have been shaving profit margins in an effort to maintain market share. They have not raised their prices nearly enough to reflect the rise in their currencies against the dollar. Take, for example, the automobile industry. Although the decline in the dollar against the yen to a new postwar low has obviously cut into the cost advantage that Japanese competitors enjoyed over American manufacturers, the Japanese have raised average prices by only 10 percent in the U.S., and even less in other markets. These increases have been insuffi-

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cient to diminish significantly Japanese auto sales in the U.S., where demand exceeds the 2.4 million Japanese vehicles that are allowed in each year under "voluntary" quotas. Moreover, quality, rather than price, may now be the most important factor in selling Japanese cars to Americans.

Another reason is that U.S. sales abroad have been hampered by the sluggish pace of overseas economic activity, prohibiting domestic exporters from reaping fully the cost advantages associated with the dollar's slide. Real GDP contracted in the first quarter in West Germany (down at a four percent annual rate, quarter-over-quarter) and Japan (down 2.1 percent, annualized), and barely inched forward in France and the United Kingdom. Economic growth must occur abroad before U.S. exports can show healthy gains.

The restrained rise in import prices and slow growth overseas are not the only obstacles to a better trade performance. Often overlooked is the fact that the countries whose currencies have increased the most against the dollar are chiefly the other industrial countries, which now account for only half our overall trade deficit. But in addition to Western Europe and Japan, the U.S. trade deficit has widened rapidly with several other areas of the world this year—including Canada and the advanced developing countries of East Asia (see chart on page 1). The widening deficit with such countries as Canada, Korea and Taiwan stems

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 7/16/86	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	196.290	+ 1.755	+16.886
Loans to Depository Inst.	.824	+ .132	− .347
Float	.272	− .526	− .390
Total Reserve Bank Credit	213.455	+ 1.377	+19.860
Treasury Deposits with Federal Reserve Banks	3.992	+ .956	+ .773
Currency in Circulation	201.542	− .262	+13.485
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	151.275	− .749	+27.021
	7/16/86		
Member Bank Reserves:			
Total Reserves Held	50.775	+ 1.510	+ 7.368
Excess (Deficiency)	.599	− .688	− .091
Net Free Reserves	.283	− .650	+ .393
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M1 (7/7/86)	673.9	+ 17.3‡	+ 12.8‡
M2 (June '86)	2,667.3	+ 11.7	+ 7.6
M3 (June '86)	3,326.9	+ 8.3	+ 7.4
Domestic Nonfinancial Debt (1st Q'86)	7,033.5	+ 8.7	+ 14.2

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 7/18/86	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	5.87%	6.03%	6.17%
* Federal Agencies	6.01	5.99	5.95
* Municipal Notes—High Grade (46% Taxable Equivalent)	7.41	7.78	8.33
Negotiable Time CDs Manufacturers Hanover		Rates By Arrangement	
* Secondary Market—Prime	6.31	6.31	6.45

‡Finance Company Paper—Prime

5- 14 days	6.30%
15- 29 days	6.32
30- 59 days	6.27
60- 89 days	6.25
90-179 days	6.15
180-239 days	6.00
240-270 days	6.00

‡* Bankers' Acceptances

Aug.	6.35%
Sep.	6.30
Oct.	6.25
Nov.	6.25
Dec.	6.20
Jan.	6.15

‡Industrial Paper—Prime

30- 89 days	6.28%
90-120 days	6.20

†Federal Funds Effective Rate 6.40%

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'86	$ 4,116	$ 4,059	$ 3,918
Gross National Product (1982 Dollars)*	1st Q'86	$ 3,617	$ 3,591	$ 3,548
Percent Change, Annual Rate	1st Q'86	2.9	0.7	3.7
Change in Consumer Prices*	May '86	2.4%	− 3.6%	2.4%
Change in Producer Prices*	Jun '86n	0.0%	7.2%	− 2.4%
Civilian Employment (Thousands of Persons) †	Jun '86	109,673	109,110	106,601
Unemployment as % of Civilian Labor Force †	Jun '86	7.1%	7.3%	7.3%
Personal Income*	May '86	$ 3,445	$ 3,448	$ 3,271
Leading Indicators Composite Index (1967=100)†	May '86	178.8	178.5	167.1
Industrial Production Index (1977=100) †	Jun '86n	124.1	124.7r	124.3
Net Change in Consumer Installment Credit †	May '86n	$ 5.39	$ 4.30r	$ 6.33
U.S. Merchandise Trade Balance	May '86	−$ 14.21	−$ 14.28	−$ 12.50
Plant and Equipment Expenditures*	3rd Q'86	$388.87(a)	$387.42(a)	$388.90
Private Housing Starts (Thousands of Units)*	Jun '86n	1,845	1,860r	1,693
New Construction Expenditures*	May '86	$ 374.7	$ 371.6	$ 352.0
Total Business Inventories †	May '86n	$ 586.6	$ 588.6r	$ 577.8
Total Business Sales †	May '86n	$ 420.7	$ 428.5r	$ 424.4

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

from the fact that the dollar's well-publicized depreciation has not spilled over to the currencies of these countries.

. . . Suppressing Economic Growth

Indeed, some of the most intractable of our bilateral trade deficits are being experienced with the newly industrialized East Asian countries (NICs), particularly Taiwan, South Korea, Hong Kong and Singapore. These nations pursue an exchange rate policy of effectively tying their currencies to the U.S. dollar. The decline in the dollar, therefore, has fueled major trade gains for these countries in general, while at the same time, the substantial appreciation of the yen against the dollar has enhanced the export competitiveness of these NICs relative to Japan in particular. Not surprisingly, the U.S. deficit with the four East Asian NICs has widened, and now accounts for about one-sixth of the overall deficit. Nor has the deficit with Canada diminished; it accounts for another one-sixth.

When will this turn around? Not anytime soon, given the erosion of the farm trade surplus, the rapid growth of the trade deficit with the East Asian NICs and the ongoing external debt problems of many developing countries that have slashed their purchasing power. Even with further declines in the U.S. dollar, it is difficult to hope for any meaningful improvement in the U.S. trade deficit this year—a disappointing turn of events which will continue to suppress overall U.S. economic growth. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (7/2/86)	152,520	– 1,365	– 1,770
New York City (7/9/86)	133,192	– 297	+ 865
Commercial Paper (7/9/86)	314,271	+ 210	+50,530

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/2/86)	260,158	+ 351	+ 4,690
New York City (7/9/86)	56,056	– 955	– 4,274

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/2/86)	742,867	+ 7,248	+ 54,601
New York City (7/9/86)	160,270	– 854	+ 9,972

Financial Markets

	Friday 7/18/86	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.83%	– .05	– 1.55
180-Day Bills†	5.99	– .04	– 1.63
Longest Bills†	6.11	– .03	– 1.77
Recent Issues:			
7s 6/30/88	6.51	– .04	
7¼s 6/30/90	6.77	– .13	
7⅜s 5/15/96	7.16	– .12	
7¼s 5/15/16	7.20	+ .02	
Municipals:			
Bond Buyer–20 Bond Index* (7/17/86)	7.45%	–0–	– 1.28
Blue List Total ($ Million)	$2,142	+ $272	+ $ 324
30-Day Visible Supply ($ Million)	$6,572	+ $330	+ $3,119
Total	$8,714	+ $602	+ $3,443
Corporates:			
Moody's Aa Composite (7/17/86)	9.25%	+ .01	– 2.11
30-Day Visible Supply ($ Million)	$3,106	+ $605	– $ 247
Stocks:			
Dow-Jones Averages:			
Industrials	1,777.98	– 43.45	+ 418.44
Transportation	727.25	– 24.13	+ 26.52
Utilities	200.48	– 3.57	+ 34.24
65 Stocks	688.00	– 17.64	+ 121.92
N.Y.S.E. Composite Index	136.34	– 3.17	+ 23.05
N.Y.S.E. Avg. Daily Vol. for Week (000's)	150,166	+ 4,998	+ 21,524

* 46% Taxable equivalent 13.80%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 7/18/86	Week Ago
Overnight	6.31%	6.44%
1 month	6.50	6.56
3 month	6.50	6.56
6 month	6.50	6.56
1 year	6.56	6.62
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	7.53%	7.62%
Long Term (7 to 15 yrs.)	8.15	8.21

FOREIGN EXCHANGE SPOT RATES New York Opening (7/18/86)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02252	44.41
Canada	.7257	1.3779
Denmark	.1241	8.0560
France	.1439	6.9490
Germany	.4649	2.1510
Italy	.0006770	1477.00
Japan	.006355	157.35
Mexico	.001610	621.00
Netherlands	.4125	2.4240
Switzerland	.5726	1.7465
U.K.	1.4955	.6687

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- La Boheme—Puccini (Italian) (S)
- Candide—Bernstein (English)
  Carmen—Bizet (French) (S)
- Cendrillon—Massenet (French) (S)
- † Don Quichotte—Massenet (French) (S)
- Faust—Gounod (French) (S)
- Die Fledermaus—J. Strauss (English)
  Kismet—Wright & Forrest (English)
  The Love for Three Oranges—Prokofiev (French) (S)
  Madama Butterfly—Puccini (Italian) (S)
- The Marriage of Figaro—Mozart (Italian) (S)
- Mefistofele—Boito (Italian) (S)
- † The New Moon—Romberg (English)
  Norma—Bellini (Italian) (S)
- The Pearl Fishers—Bizet (French) (S)
  La Traviata—Verdi (Italian) (S)
- † Werther—Massenet (French) (S)
- ‡ X (The Life and Times of Malcolm X)—Davis (English) (S)

(S) With English supertitles †New Production
‡World Premiere *Major Revival Program subject to change

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